Brazil’s Economic Outlook

Brazil, Latin America’s largest economy, is experiencing a severe recession. Economic growth has remained in negative territory for over a year and dropped to a record low in the third quarter. Tighter monetary and fiscal policy, declining exports, high inflation and a depreciating currency have all weighed on demand. Unfortunately, there are no signs of a rebound anytime soon and the economy will most likely weaken further in the coming months. Overall, economic growth in 2015 is expected to have been very weak, with GDP contracting by around 3.5%.

Brazil’s slowdown is largely the result of conditions in the industrial sector; lack of innovation and stronger import competition over the last several years have caused production to plummet. Meanwhile, significant stimulus measures prior to last year’s presidential re-election of Dilma Rousseff failed to stimulate growth and instead exasperated the issue by fueling imports and inflation. Brazil’s inflation rate is now over 10%, its highest rate since 2003 and well above the central bank’s 2.5-6.5% target range. Public finances have also deteriorated, with the public debt to GDP ratio exceeding 60%.

In order to restore credibility and stem soaring inflation, the government has tightened its policy stance significantly over the last year. Interest rates have been hiked to 14.25%, its highest rate in six years, while fiscal adjustments continue to take place. Not surprisingly, tighter policy has accelerated Brazil’s slowdown. Although there is hope that conditions will improve once the government repairs its reputation, it will likely take a few years of strong and stable policymaking before this occurs.
Unfortunately, policy efforts have yet to stabilize consumer prices or reduce the fiscal imbalance. The ongoing economic contraction has significantly lowered public revenue and caused public debt to rise by over 15% in 2015, while the nation’s rapid currency depreciation continues to raise import inflation. The Brazilian real has been on a downward trend for a few years due to the deterioration in policymaking and weak economic conditions. Waning confidence levels have led to capital flight among foreign and domestic investors, reducing the central bank’s holdings of foreign reserves. Consequently, the demand for real to purchase Brazilian assets has declined, resulting in a significant depreciation in the currency. Recently, news regarding China’s slowdown has exacerbated the issue, causing the real to plummet to a record-low against the dollar.

Despite an increase in price-competitiveness from the weaker real, Brazil’s exports continue to decline. Exports have been particularly hit by lower demand from China, its top trading partner; however, lower commodity prices over the last year have also been a main driver to the declining value of Brazil’s exports. This trend is expected to continue in the near term given China’s economic slowdown and the downward trend in commodity prices. Nevertheless, there is hope that the weak currency will eventually have a positive impact on exports.

Meanwhile, sky-high inflation and the weaker real have eroded domestic purchasing power and caused Brazil’s imports to plummet. Imports growth has remained in negative territory for over a year and recently plunged as a result of reduced investment spending following higher interest rates. Imports growth is expected to remain weak until economic conditions improve and the real strengthens.
In addition to faltering external demand, Brazil is also struggling with weak domestic demand. Lower production has reduced the demand for labor and caused the unemployment rate to reach its highest rate since 2009. The combination of high inflation and low job creation has significantly lowered income growth and household spending. This is especially troubling since private consumption has been a main driver of Brazil’s economic growth over the past decade. Consumers are expected to continue to retrench until economic conditions improve following strong and stable policymaking by the government.

Overall, we see that Brazil's economy is experiencing a severe slowdown. GDP is contracting as a result of tighter monetary and fiscal policy, declining exports, high inflation and a weakening currency. Overall, economic growth in 2015 is expected to have been very weak, with GDP contracting by around 3.5%. There is hope that the economy's contraction will slow down this year, as the government regains credibility through its policy adjustment efforts and the weaker real boosts the price-competitiveness of Brazilian exports. Nevertheless, it will likely take a few years to see significant improvement and there are currently no signs that the economy is approaching a cyclical trough. As a result, the near term outlook for the economy remains dim.